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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. ~~1322~~ 142

COLONIAL REALTY CORPORATION,
Petitioner,

against

BACHE & CO.,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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June 8, 1966

INDEX

	PAGE
Statement of the Case	1
Reasons for Denial of the Writ	4
Conclusion	6

CITATIONS

CASES:

Avery v. *Moffatt*, 187 Misc. 576, 55 N.Y.S.2d 215 (N. Y. Sup. Ct. 1945)	5
Baird v. *Franklin*, 141 F. 2d 238 (2d Cir.), *cert. denied*, 323 U. S. 737 (1944)	4
National Ass'n of Securities Dealers, Inc., 19 S.E.C. 424 (1945)	5
Silver v. *New York Stock Exchange*, 373 U. S. 341 (1963)	5
Wilko v. *Swan*, 346 U. S. 427 (1953)	3

STATUTES:

Securities Exchange Act of 1934

Section 6(b), 15 U.S.C. §78f(b)	3, 5, 6
Section 15A(b)(7), 15 U.S.C. §78*o*—3(b)(7)	3, 5, 6
Section 32(a), 15 U.S.C. §78ff(a)	6

OTHER AUTHORITIES:

H. R. REP. No. 1383, 73d Cong., 2d Sess. (1934)	5
LOSS, SECURITIES REGULATION (2d ed. 1961)	5
SEC, *Report of Special Study of Securities Markets*, H. R. Doc. No. 95, 88th Cong., 1st Sess. (1963)	5
S. REP. No. 792, 73d Cong., 2d Sess. (1934)	5
S. REP. No. 1455, 75th Cong., 3d Sess. (1938)	5

IN THE

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OCTOBER TERM, 1965

No. 1322

COLONIAL REALTY CORPORATION,

Petitioner,

against

BACHE & CO.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

Statement of the Case

The claim which is said to be so exclusively federal as to bar arbitration or adjudication in the state courts is that respondent Bache & Co., during the stock market crisis of May 1962, sold out $10 million of securities when petitioner Colonial Realty Corporation failed to meet margin calls. Colonial alleges that its securities were negligently and carelessly "dumped" (JA 8-9)* and that Bache's margin calls and charges for interest breached an oral agreement made when the account was opened (JA 4-5, 13).

Colonial is a closely-held family corporation controlled by one Selig, a lawyer (SA 1).* The precise nature of

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* References to the Joint Appendix below are indicated as "JA". References to the Supplementary Appendix below are indicated as "SA".

Colonial's claim appears not only from its complaint, but also from testimony given by Selig at a trial in the District Court on the issue whether he had entered into, on Colonial's behalf, an agreement to arbitrate all controversies with Bache (SA 1-4).

Colonial's account at Bache was devoted primarily to trading in "options"—puts, calls, straddles and the like (SA 3). At the time the margin calls were made and the securities sold out, Colonial held on margin in its account at Bache securities of the value of more than $30 million (SA 2).

Selig claimed that when he opened Colonial's account with Bache in 1954, he made an oral agreement with a Bache partner that Colonial would not be required to maintain margins in excess of the 25% minimum margin requirement of the New York Stock Exchange (SA 3) and that the interest rate on money borrowed from Bache would be one-half of one percent above the minimum rate at which Bache itself could borrow (SA 4).

However, Selig signed on Colonial's behalf when he opened the account an agreement (JA 57) which provided for the arbitration of "[a]ny controversy between you [Bache] and me arising out of, or relating to my account(s) with you or to transactions with or for me or to this contract, or the breach thereof" (par. 16). The agreement provided also that Colonial would "maintain such margins as you [Bache] may from time to time require" (par. 3) and that the written agreement containing these and other provisions could not be changed or modified except in writing (par. 7).

Selig contended in the District Court that he did not execute this agreement on behalf of Colonial, but rather in connection with a personal account (JA 83-84).

The District Court rejected Selig's testimony "on the ground of credibility" (JA 118) and stayed the action pending the arbitration to which Colonial had previously agreed (JA 120).

In an effort to avoid its obligation to arbitrate, Colonial alleged in its complaint in the District Court that Bache's demands for additional margin and the "careless" manner in which the securities were liquidated were violations of the Securities Exchange Act of 1934. The Act was violated, Colonial alleged, because this was conduct on Bache's part which was "not consistent with just and equitable principles of trade" (JA 10-12, 14-16) and because national securities exchanges and associations of securities dealers are required by sections 6(b) and 15A(b)(7)* of the Exchange Act, 15 U.S.C. §§78f(b), 78*o*—3(b)(7), to have rules providing for the disciplining of members for "conduct inconsistent with just and equitable principles of trade" in order to be registered under the Act.

Bache is a member of the New York Stock Exchange, a national securities exchange registered with the Securities and Exchange Commission under the Exchange Act, and of the National Association of Securities Dealers, an association of securities dealers likewise registered under the Act, as a national securities association.

Implicit in Colonial's theory of its case is the assumption, predicated upon *Wilko* v. *Swan*, 346 U. S. 427 (1953), that a litigant cannot be compelled to arbitrate a claim cognizable under the Exchange Act.

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* Now renumbered section 15A(b)(8), 15 U.S.C. §78*o*—3(b)(8) as the result of 1964 amendments, 78 Stat. 565.

Reasons for Denial of the Writ

I.

The alleged conflict with *Baird* v. *Franklin*, 141 F. 2d 238 (2d Cir.), *cert. denied*, 323 U. S. 737 (1944), a prior decision of the same court to which certiorari is now sought, is not a ground for allowance of the writ. No conflict is claimed with any decision of any other circuit. In any event, the decisions below are fully consistent with *Baird* v. *Franklin*, where plaintiffs sued the New York Stock Exchange for *its* failure to enforce rules which the Act required it to adopt and enforce. The court indicated only that the *Exchange* was liable under the Securities Exchange Act to customers of a member firm if the *Exchange's* failure caused the customers' loss. The case does not suggest even remotely that a *member's* violation of an exchange or NASD rule creates a federal right of action against that member.

II.

The courts below were clearly correct in rejecting petitioner's ingenious theory of exclusive federal jurisdiction under the Securities Exchange Act. It is difficult to see how the Court of Appeals and the District Court could have decided otherwise, for ingenuity alone cannot bestow sufficient merit upon petitioner's contentions to warrant their classification as "important".

We know of no statute in this country which has been construed to require a court, as distinguished from an administrative agency or quasi-public body, to determine legal responsibility in the first instance according to a standard comparable to "just and equitable principles of trade". Petitioner's theory of the Act would require the federal courts to adjudicate controversies according to

standards which have no roots in legal history or in legal precedent. As Judge Friendly concluded below (Pet. 39), had Congress intended an innovation so sweeping, the legislative history of the Exchange Act would surely bear witness to that intention; and it does not.

The congressional committee reports and the Act itself confirm instead that the whole purpose of sections 6(b) and 15A was to encourage self-regulation by the already-existing exchanges and by the over-the-counter associations which it was hoped would be organized. See H. R. REP. No. 1383, 73rd Cong., 2d Sess. 15 (1934); S. REP. No. 792, 73d Cong., 2d Sess. 13 (1934) (both discussing §6(b)); S. REP. No. 1455, 75th Cong., 3d Sess. 3-4 (1938) (discussing §15A). See also *Avery* v. *Moffatt*, 187 Misc. 576, 592, 55 N.Y.S.2d 215, 227-228 (N. Y. Sup. Ct. 1945); *Silver* v. *New York Stock Exchange*, 373 U. S. 341, 353-54 (1963); 2 LOSS, SECURITIES REGULATION 1175-1176, 1374 at n. 66 (2d ed. 1961); and SEC, *Report of Special Study of Securities Markets*, H. R. Doc. No. 95, 88th Cong., 1st Sess. pt. 1, at 3-4 (1963).

As to the statutory language, section 6(b) conditions registration of a stock exchange upon the adoption of rules providing for the "expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade". Section 15A(b)(7) conditions registration of an association of securities dealers upon the adoption of rules "to promote just and equitable principles of trade".

The phrase "just and equitable principles of trade" was included in sections 6(b) and 15A(b)(7) because it had long appeared in the rules of stock exchanges in this country and was "probably universally understood to cover the dealings of members with each other". *National Association of Securities Dealers, Inc.*, 19 S.E.C. 424, 484 (1945) (dissenting opinion of Commissioner Healy).

The statute thus does not stamp as unlawful conduct which is "unfair" or "inequitable", nor does it require the courts to fix legal responsibility upon a standard so ephemeral. Indeed, if the Act proscribed such conduct by a securities dealer it would impose an astoundingly unique standard of criminal responsibility, for each and every wilful violation of the Act is punishable by fine or imprisonment under section 32(a), 15 U.S.C. §78ff(a).

Sections 6(b) and 15A(b)(7) of the Exchange Act thus confirm a standard of business ethics which is to be applied by the exchanges and by the NASD in regulating the conduct of their members. That standard has no application to controversies in a court of law between stockbrokers and their customers, for if it did, any customer could invoke exclusive federal jurisdiction and seek to preclude the traditional remedy of arbitration by adding to its complaint the talismanic accusation that the broker acted in a manner "inconsistent with just and equitable principles of trade".

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted,

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Dated: June 8, 1966.